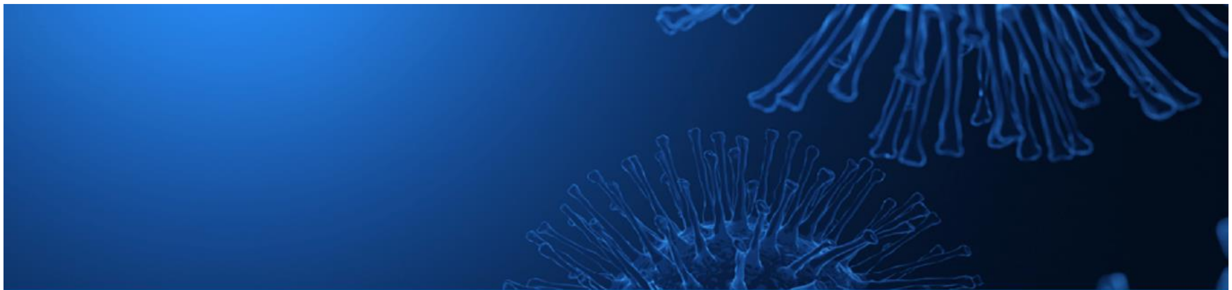

COVID-19
UK Political Analysis

By Tim Hames, Senior Adviser | 21st August 2020

Biden bid. What a Democrat win may mean for UK business in the US.

The FTI UK Political Analysis last week looked at the increased probability of a Joe Biden victory in the race for the American presidency combined with what had at one stage seemed an improbable simultaneous Democratic recapture of the Senate, and explored what the impact would be for the UK Government and how Boris Johnson may adapt in advance to this wholesale change in Washington. The implications of such an outcome are, though, not restricted to politicians but extend to the business community inside the United States (obviously) and to anyone who does or aspires to do business in and with the United States. This has particular importance for the private equity industry as the US remains the largest single player in the international market, it is a hugely important source of funds for the sector and there are many UK-based private equity investments that have been made which involve US-based acquisitions or the US as a crucial market.

The stance that a US Administration and Congress might take towards the corporate community should, therefore, be of intense interest in the UK and the EU. The scale of the coronavirus crisis and Brexit have probably served to distract attention from it. The personality of, and polarisation around, Donald Trump himself has also acted to move the spotlight away from the policy impact of a switch in control of the Oval Office, especially if it were to be fused with a Democratic Senate allied to a Democratic House of Representatives and hence at least the opportunity to advance a one-party agenda.

EXECUTIVE SUMMARY

- Although party "platforms" (statements of policy) do not play the same part in US political life as manifestos do in the UK they remain an instructive guide as to the broad direction of travel that an administration and a Congress would take.
- The economic section of the Democratic platform for the 2020 elections marks a striking shift to the left compared with such documents in the recent past.
- It includes a number of provisions involving the federal minimum wage and enhancing the legal status and strength of the trade unions that might well have significant cost implications for US business and on doing business in the US.
- There is also a substantial commitment to enhanced infrastructure spending.
- There are a number of "soft protectionist" measures that could be important.
- There is a determination to amend the tax code in a manner that would almost certainly involve notably higher tax demands on the US business sector. These include the outright shift of carried interest into the income tax category.
- There are other measures aimed at "curbing Wall Street abuse" and "Tackling Runaway Corporate Concentration" that could also change the business scene.
- UK businesses with interests in the US should be aware of what might occur.

Presidents and Platforms

Last night, ex-Vice President Joe Biden formally accepted the Democratic nomination for President. Yet if a politically interest person had fallen into a coma on the morning of Saturday February 29th (the date of the South Carolina Primary that transformed Mr Biden's political prospects) and had awoken yesterday morning, and their sole source of intelligence as to what had occurred in the previous six months was the Democratic Party Platform, then they might have legitimately concluded that Senator Bernie Sanders had won the right to take on Donald Trump as the Democrat's champion. The statement on economics and business policy is probably the most striking part of what has been a substantial shift in sentiment within the party since Hillary Clinton was defeated in 2016.

It has to be stated firmly in advance that a party "platform" in the United States is not the same sort of political manuscript as a party manifesto would be in the UK or in many other parts of Europe. It is not an obligation for the candidate, if they were to enter the White House, to treat it as a shopping list of proposals that they felt compelled to offer to Congress for legislative endorsement. There is no compulsion on any individual in the House of Representatives or Senate to support anything that is contained in this tome. There is certainly nothing akin to the UK notion of a "doctrine of mandate" in which a fantasy is maintained that every voter who backed the ultimately winning party in an election had read the manifesto from cover-to-cover, agreed with every word of it, and hence the House of Commons and House of Lords should turn its strictures into law.

Party platforms are not, despite this, inconsequential in the United States. They are a serious indicator of the broad sense of political sentiment within a party at any given time and if a party is in a position where it controls the executive and both branches of the legislature, then they are a solid guide as to the line of travel that policy might take (they are of far less value if there is divided government or "gridlock" in Washington). Hence the Republican platform of 2016 did offer an effective steer as to the thrust of the tax measures enacted by Congress and endorsed by the President in December 2017 and these remain the most important measure in terms of domestic policy during this term. What policy platforms actually assert is most definitely worth deep contemplation.

The new Democrat stance on the economy and business.

The section of the platform entitled "Building a stronger, fairer economy" is sweeping. It starts with a series of attacks on present policy and the incumbent President. It states baldly that "The economy is not working for the American people". In reference to the President it comments that "He had the audacity to pay for a permanent tax cut for big business by raising taxes on working families." It offers a critique of the contemporary United States as one where "the rich have been capturing a larger and larger share of the economic pie, with incomes for the top one per cent growing five times faster than those of the bottom 90 percent". As a consequence of this widening inequality, "children born in the United States are less likely to move up the income ladder than those in Canada, Denmark or the United Kingdom.” Major remedial measures will be required.

These are set out in what is described as “a new social and economic contract with the American people”, one that “invests in people and promotes shared prosperity, not one that benefits only big corporations and the wealthiest few.” A list of plans are set out.

The first element in this new contract involves “Raising Wages and Protecting Workers’ Rights”. It has been a very long time indeed (the early 1970s) when the official stance of the Democrats has been so closely aligned with that of organised labour. The platform pledges an increase in the federal minimum wage so that it reaches $15 an hour by 2026. It promises to prioritise passing the PRO Act (PRO is for “Protect the Right to Organize”). This cleared the Democratic-controlled House of Representatives earlier this year but has little chance of securing majority support in the Republican-led Senate. It would mean “restoring workers’ rights, including the right to launch secondary boycotts.” Further action would mean that Congress would “rein in anti-competitive corporate power by rewriting the rules that have undermined workers’ ability to advocate for themselves, including non-compete clauses, no-poaching agreements, and contracts that force workers into mandatory arbitration to resolve violations of employment law.”

This would clearly change the current balance of power. The platform insists that “We will hold executives personally accountable if they interfere in workers’ efforts to organize, including issuing criminal penalties for intentional obstruction.” Democrats would “vigorously protect all private-sector workers’ right to strike without fear of coercion, interference and undue delay”. The Bill Clinton era this is clearly not.

The drive would be achieved through regulation as well as via new legislation. Hence:

“We will increase funding and staffing at the Department of Labor to aggressively enforce wage, hour, health, and safety rules across the economy. Democrats believe employees who are being misclassified, including gig and platform workers, deserve wage and workplace protections including minimum wage and overtime pay, and we support using the ABC test to determine employee status. Democrats believe that all workers should be able to hold their employees accountable for unpaid or underpaid wages, regardless of corporate structure."

A final plank in this section of the platform starts by noting that "The United States is alone among advanced economies in guaranteeing neither paid sick leave nor paid family leave for all workers. This would be tackled as the party "will implement paid sick days and a high-quality paid family and medical leave system that protects workers from the unfair choice between attending to urgent health or caretaking needs and earning a paycheck." The party would also increase the Child and Dependency Care Tax Credit.

The second area in the platform that is set out with atypical detail for this sort of political statement is a vow to "invest in resilient, sustainable, and inclusive infrastructure." This would involve a "second great railroad revolution by investing in high-speed rail and passenger and freight rail systems." This would be supplemented by a campaign to "upgrade our nation's ports, lock and dam systems and freight infrastructure to accommodate 21st century cargo, reduce air and water pollution and create and maintain high-quality, good-paying jobs. We will increase demand for American-made ships by ensuring U.S. cargo is carried on ships flying our flag." The role of the federal government is all of this and considerably more is rendered completely explicit as:

"Democrats support the creation of an infrastructure bank, a public bank that will leverage public and private resources to build infrastructure projects of national or regional significance, including in rail and transit, clean energe and water infrastructure, broadband and affordable housing. Projects that receive assistance from the bank will be required to follow Buy America and Buy Clean provisions, pay Davis-Bacon prevailing wages, utilise project labor agreements and ensure employers remain neutral in workers' organising efforts."

Third, and already alluded to above in the references to ships "flying our flags" and the "Buy America and Buy Clean provisions", there is a lot of what might be described as "soft protectionism" in this prospectus. It includes the stance that "Democrats believe more products in our homes, stores, workplaces and communities should be stamped 'Made in America' and will expand support for American manufacturing. We will end policies that incentivize offshoring and instead accelerate onshoring of critical supply chains, including in medical supplies and pharmaceuticals.” In terms of international trade, the party argues that it would “negotiate strong and enforceable standards for labor, human rights and the environment in the core text of our trade deals”. They would “eliminate President Trump’s tax and trade policies that encourage big corporations to ship jobs overseas and evade paying their fair share of taxes. If companies shut down their operations here and outsource jobs, we’ll claw back any public investment or benefits they recieved from taxpayers.” This is, again, a very different approach to that followed by Bill Clinton when he was President or Barack Obama’s time in office.

The most full-frontal set of proposals comes under the headline “Reforming the Tax Code to Benefit Working Families”, which has as its premise “Our tax system has been rigged against the American people by big corporations and their lobbyists”. It is written that:

“Democrats will take action to reverse the Trump Administration’s tax cuts benefiting the wealthiest Americans and rewarding corporations for shipping American jobs overseas. We will crack down on overseas tax havens and close loopholes that are exploited by the wealthiest Americans and biggest corporations. We will make sure the wealthy pay the same tax rates as workers and bring an end to expensive and unproductive tax loopholes **including the carried interest loophole** [my bold letters]. Corporate tax rates, which were cut sharply by the 2017 Republican tax cut, must be raised and “trickle-down” tax cuts must be rejected. Estate taxes should also be raised back to the historical norm.”

Let no-one in the private equity industry, especially, claim that they were not warned.

There are two further, partly inter-linked, sections of the platform worthy of attention. They are less precise than some other propositions but potentially wide in inference.

The first of this final pair comes under the statement “Curbing Wall Street Abuses”. It is that “Financial institutions should never be ‘too big to fail’. Democrats will work to reverse the over-financialization of the American economy and curb Wall Street speculation by maintaining and expanding safeguards that separate retail banking institutions from more risking investment operations, and ensuring Wall Street investors pay their fair share in taxes.” This would seem to imply a Dodd-Frank Act number two.

The final assertion to study falls beneath the words “Tackling Runaway Corporate Concentration.” They are so stark in theme as to be worth quoting in their whole.

“Democrats are concerned that the increase in corporate concentration across a wide range of industries, from hospitals and pharmaceutical companies to agribusiness and retail chains, could be stifling competition and innovation and creating monopoly conditions that harm consumers. We will direct federal regulators to review a subset of the mergers and acquisitions that have taken place since President Trump took office, prioritizing the pharmaceutical, health care, telecommunications, technology and agricultural industries, to assess whether any have increased market concentration, raised consumer prices, demonstrably harmed workers, increased racial inequality, reduced competition, or constricted innovation, and assign appropriate remedies. Democrats will direct regulators to consider potential effects of future mergers on the labor market, on low-income and marginalized communities, and on racial equity, as well as on consumer prices and market competition. And as a last resort, regulators should consider breaking up corporations if they find that they are using their market power to engage in anti-competitive activities.”

Taken on face value, this constitutes a commitment to allow the federal government to intervene both in terms of mergers and acquisitions and the general performance of any market or sector and correct what it considers to be failures more or less as it sees fit.

The implications for UK business and private equity in particular.

It is unlikely that every single proposal in the Democratic platform will be rendered policy flesh even if Mr Biden defeats President Trump by a massive margin and if the Senate is swept so convincingly by the Democrats that they hold a comfortable edge of their own. The party has rarely been capable of the sort of legislative discipline that the Republicans have shown under George. W. Bush and Mr Trump when they had small majorities. Yet, on the other hand, it would be a surprise in these circumstances if a new all-Democratic Washington, D.C. did not witness versions of some of the measures set out in the party platform enacted (where new laws are needed) or implemented (by federal agencies). Failure to do so would imperil the party come the mid-term elections of November 2022.

So, it should be assumed that much of what has been set out here may come to pass. This has sizeable implications for UK business in general and private equity particularly. Some of them are absolutely clear. Others are more opaque in their ramifications. Five broad areas of potential concern will be the subject of a concise examination here.

The first is that the cost of conducting business within the United States will increase. A markedly higher minimum wage, the enhanced capacity of labour unions to press for more attractive conditions for their members and an expansion of social benefits will make that close to unavoidable. Much of this will be widely supported by the public and probably privately by employers as individuals. It does indeed appear an anomaly (to a European at least) that the US is, as the Democratic platform rightly says, "alone among advanced economies in guaranteeing neither paid sick leave nor paid family leave for all workers." If enacted, it would be difficult to imagine the political circumstances in which they would be subsequently repealed. Like Medicaid and Medicare in the 1960s and the original social security schemes of the 1930s they would prove to be untouchable later.

To some degree there would be a trade-off between those costs and the benefits that might flow to business in the United States as well as society at large if the huge sums of money that are being pledged to a wide variety of infrastructure schemes do materialise. There is much about this in the US (like the UK) where modernisation is essential. The difficulty for many companies is that the increase in their costs is immediate whereas the benefits from federal government expenditure that they might secure if a coherent plan for investment in infrastructure emerges will not occur until the medium-term at the very earliest. For the early 2020s, there would be a shift from capital to labour. This increase in expense will take place as the US and the international economy attempts to escape from the intense downward spiral that the coronavirus crisis has created for it.

The second is more amorphous, in that it refers to the cultural environment in which business co-exists with everyone else and everything else. The tone of the Democratic platform this year is astonishingly hostile to larger corporations. There are not even token words about the value of wealth creation or the good that entrepreneurs have achieved for Americans (or anyone else) through their relentless quest for innovation. The only sub-sector of the capitalist world that earns a slight pat on the back are small businesses which are hailed as "among the best job creators in our country" and who are worthy of support from Washington "especially for small businesses owned by women and people of colour". Big business, by contrast, and by extension their management, are consistently painted as self-centered, self-advancing, self-interested parasites. This outbreak of quasi-Corbynism in the US Democratic Party verges on the breathtaking.

The third is that a more assertive federal government encouraging a series of its own agencies to be more interventionist than in the past will make the day-to-day pursuit of business activity more complicated and make compliance a more central component of life. All of business, but notably that associated with private equity, might be wise to conclude that attack was the best form of defence and move assertively and publicly to upgrade their environmental, social and governance standards and structures so that a Democratic White House and Congress does not feel the need to do so radically itself.

The fourth plainly relates to the tax code. If there is one single item that a Democratic Washington will make its single most important mission, it will be to overturn virtually all of the 2017 Republican legislation and implement a very different vision of its own. The top rate of income tax in the US would increase (perhaps to 40% or even higher), the set of corporate tax reductions that were implemented under the Trump Administration will not merely be reversed but will probably end up higher than they were beforehand. They will stay that way until there is another moment when the Republicans run everything.

This would have a disproportionate impact on private equity funds and their managers. Most of then presently pay a high proportion of their taxes in the form of capital gains tax on carried interest at a 20% rate (before the accountants start to work their magic). Shifting carried interest into the realm of income tax and with the probable top rate of US income tax that Congress will eventually settle on would essentially double the rate. The US would move from being one of the most lucrative locations amongst advanced democracies in which to work in the private equity sphere to one of the least enticing.

This could have secondary consequences of an unpredictable character. It might set a new international norm that leads other governments across the globe to look again at their carried interest arrangements and make a hostile move politically appealing (at the moment, of the G8 nations only Japan taxes carried interest universally as income). A smart public affairs and engagement strategy, with Brexit as a helpful alibi in this case, could see the opposite become true as ministers and officials are made aware that they could ignite a flight of private equity talent from the United States to the UK if they were to include carried interest in the conventional UK capital gains tax rate which is 20%.

Finally, acquiring companies in the United States could become more challenging if the "Tackling Runaway Corporate Concentration" dictum becomes the basis for hard policy. A review which has "prioritising the pharmaceutical, health care, telecommunications, technology and agricultural industries" for the past and future desirability of mergers and acquisitions is one which is covering the majority of American economic activity. External investors will need to take care in how they present themselves to the federal government if they are not to find themselves shut out of sectors they want to buy in.

All of which leaves us with something of an irony. In November 2019, there were many in the US business community who had historically conducted business in the UK left asking themselves what life would be like if there were to be a complete change of government in this country. In November 2020, it could well be that a swathe of UK business leaders who have traditionally been involved with the US economy will be out there wondering, irrespective of their personal views on Donald Trump, what a change in the Oval Office and Senate of the United States may mean for their individual and institutional interests.

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